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Black Tax: Evidence of Racial Discrimination in Municipal Borrowing Costs

Municipalities with higher proportions of Black residents pay higher borrowing costs to issue bonds rated by credit rating agencies compared to other cities and counties that issue within the same state and year. These higher costs are unexplained by credit risk, more pronounced in states with higher levels of racial resentment, and robust to state-tax incentives to hold municipal bonds. The findings illustrate that racial bias can increase borrowing costs, particularly in states where racial resentment is severe. In time-series tests using presidential and gubernatorial election periods during which racial resentment has been shown to intensify, we find that the differences in borrowing costs also increase. Collectively, the findings illustrate that racial bias can increase borrowing costs, especially where racial resentment is severe.

We focus on rated bonds offered directly by U.S. cities and counties from 1990 to 2019. Controlling for credit risk, our main finding is that a one-percentage point increase in the total proportion of Black residents in a municipality is associated with a 0.44 basis point increase in total annualized costs. For example, in 2019 the municipalities in our sample raised a total of $77 billion from rated municipal offers. When we take the product of our cost estimate (0.44 basis points), each municipality's percentage of Black residents, and each offer's issue amount and maturity, we find that the Black Tax costs these communities a total of $110 million. This is notable since the sample is national and therefore includes cities and counties with relatively little racial diversity as well as those with higher concentrations of Black residents. Regional analysis suggests that there are areas, such as the Western states, in which municipalities pay a penalty as high as two basis points. We also find some evidence that cities and counties with higher proportions of Hispanics pay higher borrowing costs.

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